

Business Incubators Give New Firms in Rural Areas a Head Start

Four out of five new businesses fail within their first 4 years. Business incubators, sponsored by local governments or other groups, can help shorten those odds. Incubators provide business services and rental space, at below market costs, for a business's first few years. The payoff for the community is more jobs. Rural incubators may be more difficult to get going than incubators in more populous areas, but worth the investment.

Rural development officials, like development officials nationwide, are pursuing a wider variety of approaches to strengthen local economies than they were just 5 years ago. In addition to recruiting manufacturing firms, development strategies also focus on attracting service-oriented firms, keeping existing businesses in town and helping them expand, and helping small businesses start up and grow.

Small business development is now a key aspect of economic development strategy. Small businesses account for most of the job growth in the United States. Firms with fewer than 20 employees created about two-thirds of all new jobs from 1969-76 and firms with fewer than 100 employees created 80 percent of all new jobs. Almost 700,000 businesses start operations in the United States each year; but they have a high failure rate, perhaps as high as 80 percent during their first 4 years of existence. The reasons for small business failure are usually poor marketing, poor management, or lack of capital.

By giving a hand to some of those businesses, local governments may be able to

Mark Weinberg is an associate professor in the Political Science Department and director of the Institute for Local Government Administration and Rural Development at Ohio University, Athens.

lower the high rate of attrition. Development strategies to reduce the failure rates can include traditional tax and financial incentive programs, special research and development programs for small businesses, seed and venture capital financing, training programs for entrepreneurs, regulatory relief for small businesses, customized assistance programs, and business networks development.

One of the newest and most rapidly expanding small business development tools is the business incubator, a sort of safe harbor for fledgling businesses to operate until they are able to move into their own facility in the community. Before 1980, fewer than 10 incubators existed. By 1984, 40 incubators were in operation. By early 1985, 65 were operating. Nearly 150 incubators were operating by the end of 1986, and that number is expected to double by the end of 1987. One estimate puts the number of incubators in the United States at between 750 and 1,000 by 1990 (see chart).

Incubators Help Small Businesses Survive

Incubators help small businesses in the early growth stages by providing them rental space, shared office services, management and business assistance, and a creative entrepreneurial environment. Those services are provided in exchange for rent payments and occasionally equity in the business or future royalties. Rental arrangements can include access to conference facilities, custodial service, building security, furniture and equipment rental, luncheon facilities, and other physical amenities. Incubators also provide shared office services like copying, clerical assistance, mail service, word processing, shipping and receiving, and answering and receptionist services.

Management and business assistance can include entrepreneurial training, product evaluation, business forecasting, assessment of technical and commercial risks, marketing, financial and managerial assistance, and patent and legal assistance. These services are generally provided by incubator center staff, other incubator clients, or through contractual relationships with outside consultants, retired business personnel, or university or government business counselors.

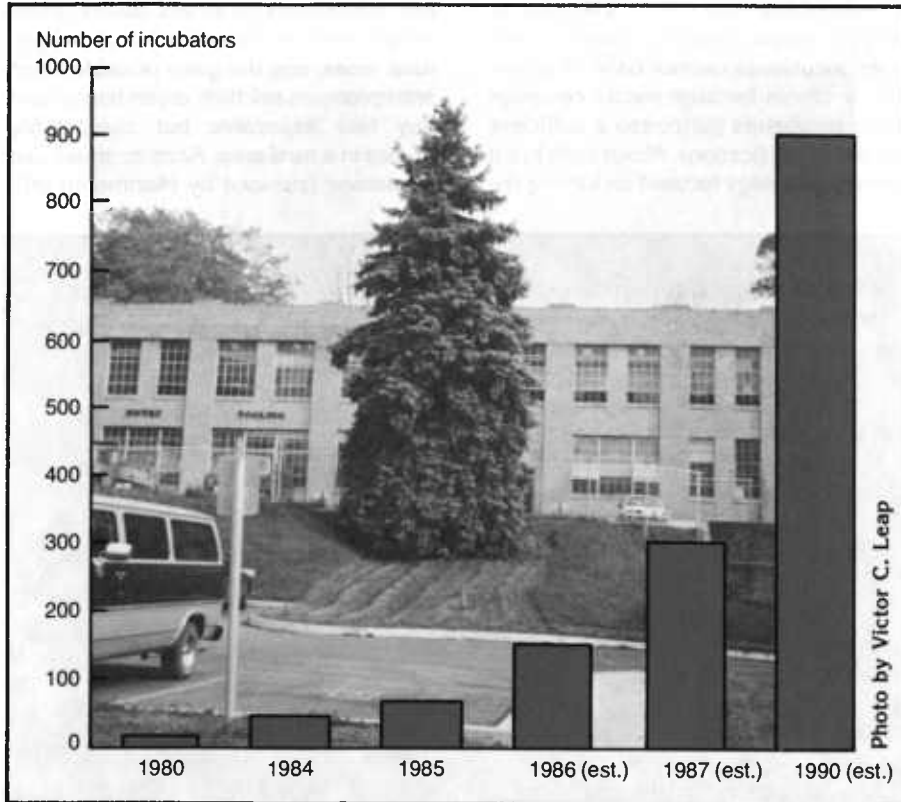
Incubators are sponsored or operated by public and nonprofit agencies, educational institutions, private organizations, or a combination of such organizations. Rural incubators in western Illinois, for example, are sponsored by the community, receive State funding, and operate under a licensing arrangement with Control Data Corporation, a private company. Sponsoring organizations start incubators for many reasons: to diversify the community's economic base, to use vacant property in a community, to enhance a community's image as a center for innovation and entrepreneurship, and, most important, to increase employment opportunities. The importance of these objectives varies by the type of sponsoring organization. A publicly owned and operated incubator, for example, might be primarily interested in diversifying the local economy, whereas officials of privately owned incubators may view the incubator solely as a real estate or capital investment.

Incubators also vary in terms of their tenant composition. Some have mainly retail or wholesale operations, some have mainly light or heavy manufacturing and warehousing, others specialize in professional or personal service firms and governmental and nonprofit agencies, and still others operate as a mixed-use facility offering a little of everything.

Incubator facilities in the United States vary with each community. However, successful development of a business incubator involves five key dimensions:

- Establishment of an entrepreneurial environment or complex network of organizations and actors that assist entrepreneurs in the community,
- Development and management of a multi-tenant facility,
- Provision of business services to firms in incubators,
- Provision of office services to clients,

Business incubators in the United States



The Meadville Incubator in Meadville, PA, and others like it help new businesses get through the critical first few years of operation.

- Provision of tenant access to capital (equity and debt) from the local business community.

Businesses benefit from incubators in several ways. Incubators have been able to reduce the failure rate of new businesses by providing systematic assistance to small businesses. A national study has shown that two-thirds of the firms in incubators successfully graduated and 80 percent of those firms relocated in the surrounding community.

Business survival, the purpose of the incubator, increases as a result of the specific services offered by the incubator and the common experiences shared by entrepreneurs in the facility. While the types of services and assistance vary in importance to the incubator's tenants, individual services can be crucial to the survival of a firm. For example, tenant access to incubator computer facilities can allow firms to engage in direct-mail efforts to dealers or customers; or up-front marketing surveys by incubator staff can help entrepreneurs avoid costly marketing errors by identifying proper markets for products and inform them of product and price competition. Finally, the immediate

availability of this assistance is an important asset to incubator clients and is in this way superior to traditional management assistance programs offered to small businesses.

Businesses can also derive intangible benefits from participating in an incubator. Incubators can help firms gain entry into area business networks, which can provide information on real estate location for when the firm graduates from the incubator or on alternative financing arrangements for business expansion. Many incubators hold weekly meetings for all tenants. These meetings offer tenants opportunities to engage in joint problem-solving, offer support to others facing similar problems, and provide an outlet for other types of information exchange and an opportunity to discuss mutual commercial interests.

Business Incubators Work in Rural Areas, Too

The National Business Incubator Association listed 155 incubators in the United States in 1986. About 21 of them (14 percent) were located in communities with

populations under 25,000 in a non-metropolitan county. Rural incubator facilities are found in communities whose population ranges from 475 (Atlanta, MI, home of the Montmorency County Industrial Incubator), to 19,473 (Athens, OH, in Athens County, the location of the Ohio University Innovation Center). The median population surrounding rural incubators is 10,208. Another nine incubators are located in cities under 25,000 population, but in areas that do not strictly meet definitions for a nonmetropolitan county.

Incubator development in rural areas is more difficult than for more populous areas and rural development officials may find that what works for an urban area may not work in a rural setting. Incubator development may also take longer. Alternative incubator strategies and models and exceptional indigenous leadership may be necessary for incubator officials to succeed in rural areas that face restricted:

- Entrepreneurial clientele pool and limited access to regional and national media to construct a marketing strategy to attract entrepreneurs,
- Financing because of a lack of private capital and willingness to invest in new business ventures, and
- Public and private economic infrastructure.

However, effective community leadership and appropriate rural incubator strategies can lead to the successful development of incubators.

Overcoming A Limited Client Pool

The number of potential clients for an incubator in many rural areas is limited because of a small population and a general lack of an industrial base. Without an industrial base, the potential for spinoffs from research and development divisions of existing business is virtually nonexistent. For example, the Ohio University Innovation Center can draw only on Athens' 8,000 nonstudent population and the county's 56,000 population. The city's economic base is limited in terms of the number of firms, the economic diversity of Athens, the industrial mix of southeast Ohio, and the geographic isolation of the area. Some of northwest Pennsylvania's incubator projects do not face such problems because they are located in areas adjacent

to larger cities and because the region's industrial base, while aging, is nonetheless significant.

Incubator managers and developers in rural areas often try to overcome the low number of potential entrepreneurs in their areas through aggressive marketing. Yet,

the marketability of incubators is limited because of limited access to a regional or national media network. Some urban-based incubators did not have to advertise for clients because media coverage of the incubators generated a sufficient number of applications. Monmouth has a marketing strategy focused on turning the

potential disadvantages of a rural location into advantages to attract clients. Monmouth stresses the amenities of living in rural areas, and the gains possible when entrepreneurs sell their urban homes and buy less expensive but comparable homes in a rural area. Another smalltown advantage (stressed by Monmouth offi-

Facts on Some Rural Incubators

Rural incubators vary in terms of sponsorship and tenant composition. This diversity is illustrated through a description of several incubator projects. Two of the longest running incubator projects in rural areas are the Western Illinois Project and the Northwest Pennsylvania Regional Incubator Project.

The Northwest Pennsylvania Regional Incubator Project started in 1984, with plans for four incubator facilities—three industrial or light manufacturing incubators and one retail incubator—to be located in four small towns in northwestern Pennsylvania. The project includes incubators in Girard (population 2,600), Warren (population 12,146), and Meadville (population 15,554). The incubators in Warren and Girard are the furthest along and provide useful illustrations of incubator development.

Unlike other private incubators and almost all publicly sponsored or operated incubators, the facility in Warren, PA, is a retail incubator. The incubator initially included six retail outlets and one fast food client. An insurance firm acted as the anchor tenant. The retail nature of the incubator distinguishes its operation from the other incubators in the project in a number of ways. The Warren incubator encourages its clients to move into the community at an accelerated pace, as soon as they are strong enough to do so. However, leases do not specify a time period that a client can remain in the incubator, as is common with other facilities. Unlike other incubators in the project, the Warren facility does not provide traditional support services to its clients,

but focuses on maintaining the physical attractiveness of the facility. Warren's incubator was originally owned and managed by the Economic Opportunity Council of Warren County (a community action agency) and the Private Industry Council. In January of 1985, it was sold to a private owner and still operates as a privately owned incubator.

The Girard Commons Center for Enterprise Development is located in Girard, PA, a town with a population of 2,615. However, Girard is only 15 miles from Erie, a city of 120,000. The Girard incubator was funded through Appalachian Regional Commission, Economic Development Administration, city funds, and industrial revenue bonds. The incubator provides both management and business services, typing, copying, conference and reception services, and equipment rentals. Rent at the incubator is well below market rates and includes utilities and custodial services. A management team at the incubator provides business planning, loan packaging, product development, and marketing assistance. The incubator housed 18 tenants as of June 1986 including light manufacturing, injection molding, tool and die firms, and engineering firms. The developers of the incubator project expect that these businesses will employ 250 people by the end of 1986.

The western Illinois incubator projects are located in McComb (population 18,000), home of Western Illinois University; Monmouth (population 11,000), home of Monmouth College; Quincy (population 60,000); and Galesburg (population 38,000). These cities are too distant from any major cities to draw on any urban resources. The project

is unique in that all the incubators were developed under a special licensing arrangement between Control Data Corporation, the Illinois Department of Commerce and Community Affairs, and the four cities. All the incubators are nonprofit, whereas Control Data's experience had primarily been with the development of privately owned and operated incubators, which they called Business Technology Centers. Control Data provides management and technical assistance to each incubator, but each incubator is locally owned and operated by the city or an independent community board. Each city was charged a \$75,000 fee by Control Data to set up the incubator. The fees were paid from the State's Small Cities Community Development Block Grant funds and through Job Training Partnership Act dollars.

The McComb incubator, the only university-related facility, is located in a dormitory donated by Western Illinois University. McComb is an office services incubator. Monmouth's incubator, owned and operated by the city of Monmouth, is located on a 7.6-acre site with five buildings. It is a mixed-use incubator in terms of tenant composition with 75,000 square feet. The two incubators have 14 tenants who use 35 percent of available space. Monmouth's objective is to have 25 firms occupy the incubator. Incubator policy is set by a manager with the approval of the city council. The incubator offers support, shared office services, and business consulting services to tenants and also provides services to firms outside the incubator.

The Quincy and Galesburg projects are still in the initial stages of development.

cial) is that the services available to a business, while more limited, are also more easily coordinated into an accessible network, a key to incubator development, unlike in an urban area where services are fragmented. Finally, the four incubators in western Illinois joined together to market their incubators in national publications to lure entrepreneurs to their area. The incubators received over 200 inquiries from their advertisements.

Another alternative to the problem of a small pool of potential clients is to focus on the development of entrepreneurial enterprise from area universities. Several rural incubators have pursued this strategy. For example, the Ohio University Innovation Center has recruited 7 of its 11 tenants (64 percent) from university faculty and staff. Universities may also help attract clients, especially high-technology entrepreneurs, to an incubator, according to M. Alison Buck and Daryl Hobbs of the University of Missouri. Based on a survey of high-technology entrepreneurs in 57 rural university settings in the United States, they concluded that high-technology entrepreneurs were more likely to start a business in a rural setting if a university were present. This is especially important because rural areas often lack adequate access to air and ground transportation, product and supplier markets, and other elements common in metropolitan areas.

A limited client pool may also force a change in the basic structure of the incubator, perhaps necessitating a greater flexibility in client selection. Rural incubators may need to relax restrictions on the type of tenant admitted to the incubator, placing an equal emphasis on service clients as on product-oriented or manufacturing concerns. An anchor tenant may be sought who can stimulate product suppliers from the community. Rural officials may have to settle for small incubator facilities with fewer clients, provide incubator services to clients in various locations, and be satisfied with slower rates of entrepreneurial development than what one would expect in an urban area. Candace Campbell, David N. Allen, and other national authorities on business incubator development contend that the service, information provision, and creative environment components of incubators are more important than the facility itself in successful incubator development. Stephen A. Webster, a business consultant specialist, and other officials of the

Photo by Dianah Adkins



Regular get-togethers give incubator tenants an opportunity to exchange ideas and lend each other support.

Wisconsin Community Development Finance Authority have experimented with alternative assistance models to incubators in rural Wisconsin.

Arranging for Incubator and Tenant Financing

The ability of incubator developers to provide debt and equity financing for tenants may also be more difficult in rural areas because there is less private capital and less willingness to invest in such ventures than in larger areas. As Gail Imholz, incubator project director for the Illinois Department of Development, points out, incubator developers in Chicago were able to raise money through local limited partnership schemes, but such a financing arrangement was not possible in rural western Illinois because of a lack of interested investors. Access to venture capital funds is also limited. Seed capital financing, money needed in the early stage of business startup, is a problem for tenants in rural incubators.

Similarly, many rural areas do not have large banks with the available resources needed for business expansion. Rural banks may be less likely than urban banks to participate in a complex loan (where another entity guarantees a loan or funds part of a development project). A recent study by Steven J. Taff and associates at the University of Wisconsin at Madison found that most banks in rural Wisconsin

had little experience in making complex loans: 47 percent made no loan that involved third-party guarantees, 59 percent sold no loans, and only 40 percent of the banks surveyed made any loans over their legal minimum. A handful of banks accounted for most of the business loans. A similar study of rural banks in southeast Ohio suggested that many rural banks generally do not have staff trained in development finance. Their volume of commercial loan business does not justify such staff, and therefore the staff do not understand public loan programs and are unable to deal with the complexity of these programs. However, these findings do not necessarily apply to banks in all rural areas and the growth of bank affiliates of large bank holding companies makes this issue less important.

Incubator developers in rural areas may need to develop community-based seed capital financing for new business startups or venture capital funds to provide small amounts of capital to tenants for business expansion or they may work with State officials to ensure adequate capital financing for incubator tenants. Incubator development costs are now eligible expenses in many State and Federal financing programs. Many States have recently expanded existing economic development programs to include financial and technical assistance to incubators or enacted legislation which specifically obligates the State to promote incubator

development. For example, the North Carolina Technology Development Authority created by the State legislature in 1983 has funded four technology centers, two in rural communities in Haywood and McDowell counties in western North Carolina, and two in the Ahoskie and Goldsboro communities in rural northeastern North Carolina. The Ben Franklin incubator program in Pennsylvania has provided crucial operating capital to the incubators in northwest Pennsylvania and loan funds for incubator tenants through the regional development agency.

Overcoming Inadequate Infrastructure To Spur Economic Development

Finally, a major liability for rural officials is the lack of an adequate public and private economic development infrastructure in rural areas. Most large cities have development departments with directors and qualified staff who assure access to State and Federal funding for development projects. Many rural areas lack experience with business development projects and the resources to hire development staff (though many small communities now hire economic development specialists like the communities in the northwestern Pennsylvania incubator projects). Providing money to hire an economic development professional is beyond the small budgets of these areas. Larger cities have greater access to institutional grants and foundation money for startup projects as well as access to specialized service firms like patent attorneys and marketing firms often not available in rural areas.

Community commitment and maximization of available resources is one possible solution to these problems. To start its incubator, the city of Monmouth undertook a local drive patterned after a United Way appeal campaign. Monmouth was successful in raising \$200,000 from businesses, residents, banks, and major companies. Also, the city located its Chamber of Commerce, Small Business Development Corporation, Service Corps of Retired Executives, and City Zoning Office in the incubator to maximize the level of public and private assistance available to tenants in the incubator. Monmouth's level of community commitment to this project is a key ingredient to the success of its incubator.

Other solutions to these problems might include university assistance in starting incubator networks and direct technical assistance to communities for incubator startup and operation. For example, Ohio University is working with several communities in the Athens region to develop incubators under a technical assistance demonstration grant through the U.S. Department of Housing and Urban Development and the State of Ohio. Regional technology centers in Pennsylvania provide incubator assistance through the Ben Franklin Partnership program.

Business network development and technical assistance could also be provided by other educational institutions, regional development agencies, the Cooperative Extension Service, Chambers of Commerce, or other organizations. However, traditional development organizations may be inexperienced in or unsupportive of entrepreneurship development.

The resources available to rural development officials to start incubators have increased dramatically in the last 2 years. Several technical manuals are available that cover the basic mechanics of incubator development. Many more incubators exist now than just 2 years ago, and officials have a wider range of experience to draw on.

Business incubators represent one economic development option for rural areas. Given the newness of this tool, it is still too early to know if incubators are a success, though early results are promising and the incubator strategy compares favorably for rural areas with other development alternatives. As businesses succeed, communities benefit from the incubators. While most of the tenants of new incubators tend to be existing small businesses, as the incubator matures the percentage of new startup businesses increases. No evidence exists that incubators merely induce firms to change location. Incubators help create new jobs for communities by encouraging new businesses and help preserve those jobs by slowing the attrition rate of new firms, allowing them to minimize fixed costs and helping them with cash flow problems. While the number of new jobs may not be a large percentage of a local economy, the incubator may be a rural community's only source of new job creation and it can act as a catalyst for the creation of an entrepreneurial culture in the community.

Government and development officials need to review their local economy and assess the level of government and community support in the area before deciding what type of incubator, if any, to establish. The key to an incubator's success is the leadership in the community and its willingness to develop the innovative marketing and recruitment strategies, financing techniques, professional service networks, and local government and community support. For example, the mayor of Monmouth has been the driving force in the success of the incubator there. Successful incubator development often seems to depend on one individual who can assemble all the necessary ingredients and galvanize groups in the community to work together. In communities where individuals and development groups insist on competing against each other, incubator projects and other development projects generally proceed much more slowly.

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For Additional Reading...

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